DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

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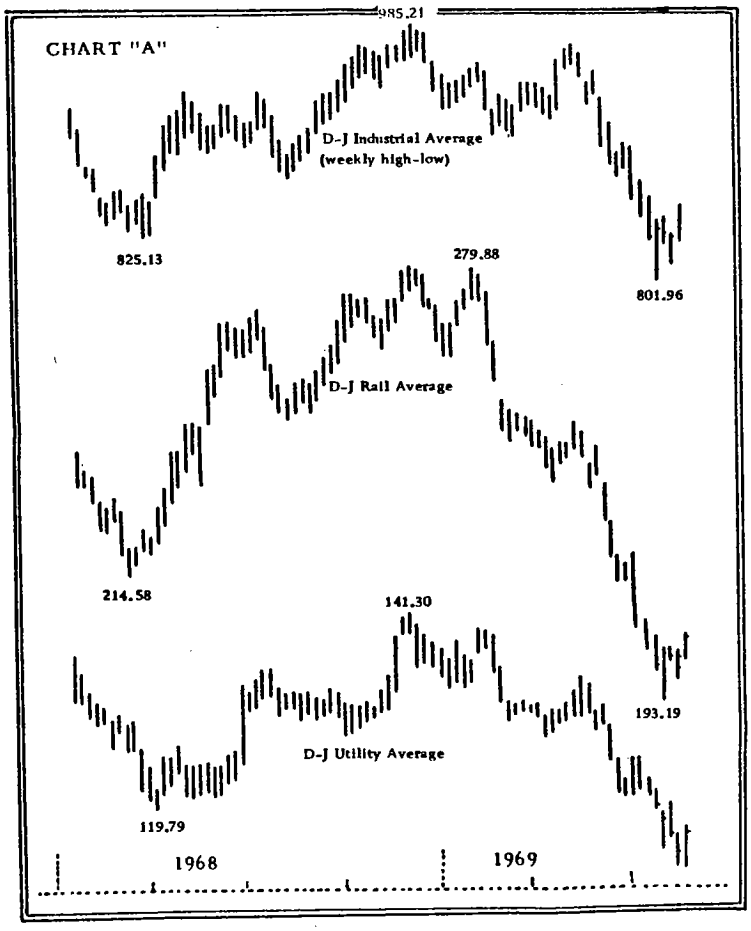
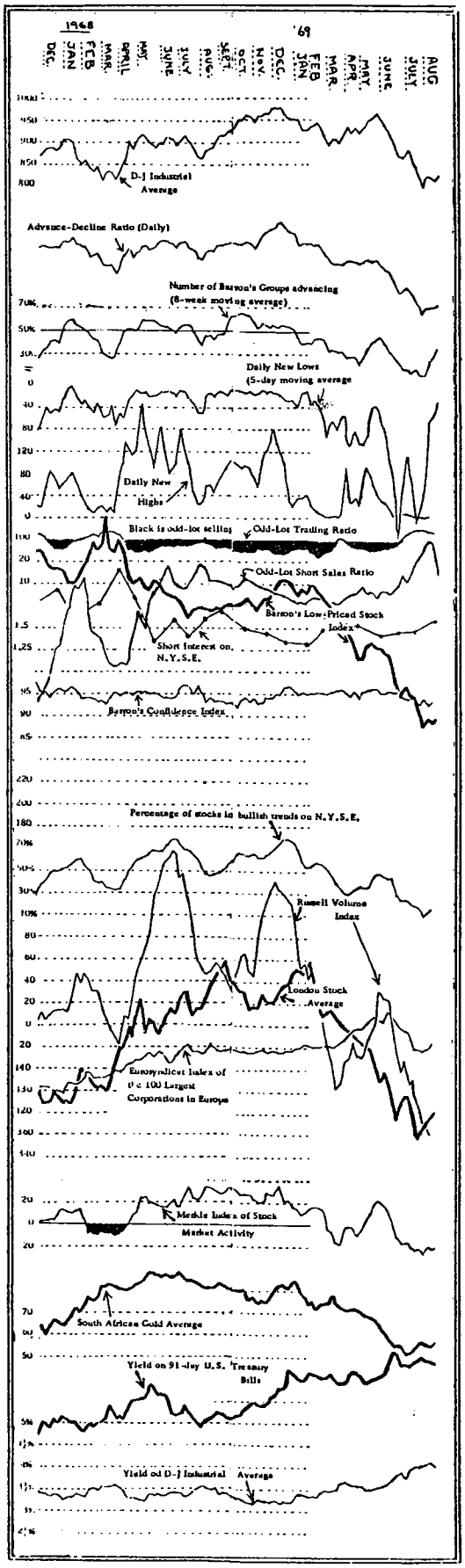
THE MARKET: As U.S. Industrial output rose to a record in July and as consumer prices continued to push higher, the Administration was faced with the possible necessity of keeping the monetary squeeze on, even tightening it, in the hopes of ultimately halting inflation. But a nagging fear was beginning to be felt. Would 1970 be a year in which economic growth actually reversed, even while prices pushed up and even while inflation was still in the saddle? Such was the worst nightmare of the Nixon Administration, as it wracked its collective brain for new plans to tighten the screws on inflation, no matter where such inflation pressures appeared.

Two areas of new rules and regulations have already loomed, the possible removal of municipal bonds from tax-exempt status and the new regulation requiring U.S. banks to keep reserves of 10% on certain portions of their Eurodollar borrowings. It is estimated that the new Eurodollar regulation will require New York banks to increase required reserves by $700 million.

The total dilemma seems to be increasing almost daily. For instance, last week the July figures for new durable goods orders were released— up 5.5% for the strongest rise since last autumn. The consumer price index was also announced— up a fat .5% or 6% a year on an annualized basis. Paul McCracken, the President's Chief economic adviser, called for "patience,"



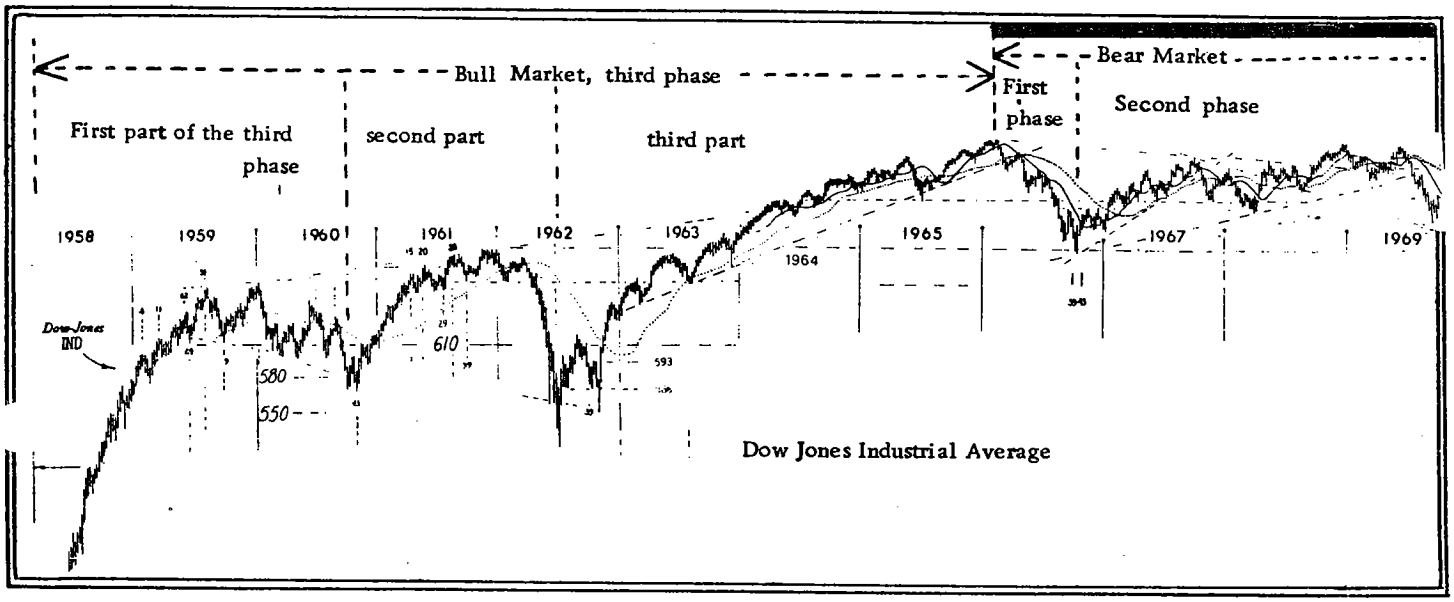

1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (6-week moving average)
Daily New Lows (5-day moving average
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Merkle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield on D-J Industrial Average

 stating that the time was not right for an easing of monetary conditions, and adding something about a "monolithic lack of confidence in the price level."

This week, instead of the daily chart of the Averages, I have included a longer-term weekly chart of the three Dow Averages, covering the period of 1968 to the present. The chart is drawn to semi-logarithmic proportions, so that it shows percentage of movements in each of the Averages.

As seen on the chart, the Rails have done poorest on a percentage basis, having erased 30% of their total value during 1969. On a price structure basis, the Utilities have acted worse, being the only Average to break below their 1966 low to new bear market lows. The Industrial Average has lost 18% of its value in 1969. But whereas Rails halted their 1969 decline just points from their 1969 low, Industrials at the 801.96 low were still 57 points above their own 1966 low of 744.32.

So far, the rally (see chart, page 1) which began at the July 29 lows is decidedly sub-standard in extent. In duration the rally is not yet one month old. Therefore in both duration and extent the rally hardly classifies as a correction of the 1969 decline. Whether we are now seeing a mere interruption of the downward movement or whether we are moving into a full-scale correction remains to be seen. One observation: The advance has been both halting and extremely selective. If the rise is to be impressive, that part of the movement lies ahead.



CONTINUING SECOND PHASE: There still appears to be some confusion among subscribers as to where we are in this bear market. I have included a weekly chart of the Dow Industrials running from 1958 to the present. The major portion of the chart traces the progress of the third and final phase of the 1949-1966 bull market. Remember, the third phase of a bull market is the speculative phase, the phase in which the public comes to Wall Street amid great enthusiasm. This is also the phase in which true investors distribute stocks which they have purchased many years earlier at bargain prices.

The amazing thing about the 1958-1966 third phase was that it was the longest such wind-up in bull market history. In fact, it progressed in three distinct steps or parts, and these parts are designated on the chart. One can speculate as he studies the chart that the bull market should have ended in 1960 or 1961, but the market has its own way of telling its story, and the story during 1958 to 1966 was one of continual Governmental infusions of money and inflation. Thus instead of ending it the January, 1960, peak of 685, the Dow pressed on and on, finally exhausting itself at 995.15 in February, 1966.

The first phase of the bear market began in February, 1966 at the 995.15 peak. By October of that year the Dow had fallen to 744.32. This terminated the first, short phase of the new primary bear market. The first phase served to inject some reality into Wall Street. It jarred people, it showed them that inflation and Presidential edicts don't always produce market advances. By October, 1966, the Dow was back below its 1961 inter-day peak. Five years of upward progress had been wiped out.

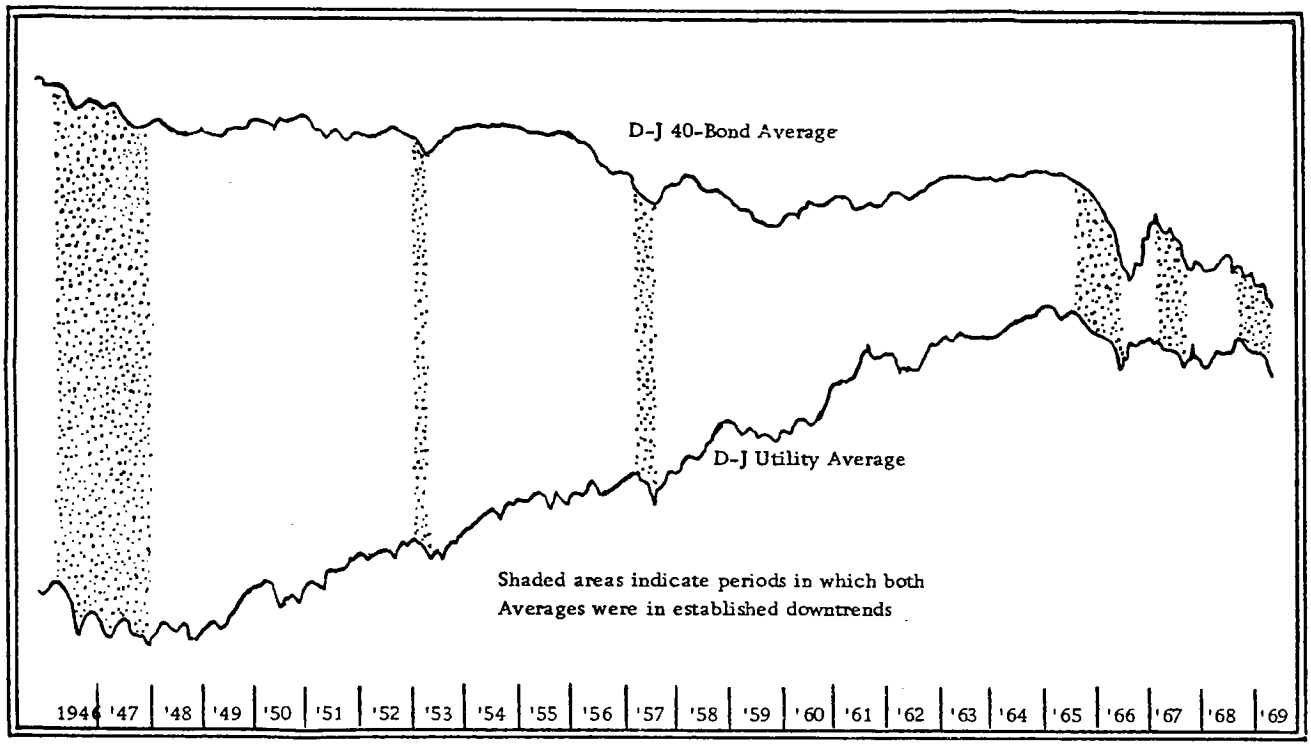
Then came the classical fooler, the massive speculative upward push which by late 1968 had taken the Dow within 10 points of its 1966 bull market peak. Again Wall Street was agog with predictions that the fabled 1000 level would be breached. It was not to be. The vicious decline of 1969 took the Dow back to a closing price of 801.96 on July 29. At the 1969 low the Industrial Average was below the 1964 high of 891.71 and within 66 points of its 1961 peak. To all purposes, eight years of upside progress had been erased.

But the bullish sentiment of seventeen years (1949 to 1966) is not easily erased. As this is written hope is being rekindled that a "new bull market" is in progress. Hope is being expressed that the problems of the world will somehow go away or be taken care of. Yet, if this bear market is to run true to form, I can state that all we have seen so far is the early hint, the scent of the real trouble which lies ahead.

True, many stocks have suffered severe losses during 1969. Many speculative issues have lost one-half to two-thirds of their value. Yet before this bear market is over, I predict that we are going to see a startling change in Wall Street psychology. We are going to hear people say that they "never want to hear about the stock market again." We are going to see losses which far outweight anything seen so far. We are going to see Exchange volume drop to perhaps 10% of that which was seen on the top, in other words perhaps 1.5 to 2 million shares per day.

Finally during the third phase of this bear market we are going to see a market sinking listlessly into the doldrums, with buyers scarce and sellers exhausted. The real bear market panic has, so far, been put off. All declines since 1966 have been polite and on light volume. But this too, is an anomalywhich will be corrected in time. Every bear market, following a great bull market, has produced its moments of panic, of hysterical, unreasoned selling. This bear market, I believe, will be no exception. But first, it is possible that 1969 will see one more surge in hopes and optimism, one more "drawing in of the gun-slinger," one more fleeting rekindling of enthusiasm among the public.

But any push from here will not undo the damage, and it will not erase 1969's huge losses. As usual, it will require patience and even stubborness from those who follow Dow's Theory. We will buy when the time is right and all the indications point to the arrival of a great buying area. No such area has yet arrived. (Chart courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas).



AN UNUSUAL STUDY: The Averages are incredible mechanisms. If any single person ever succeeded in understanding what the Averages were "saying," he would surely control half the money on this earth. Huge and voluminous studies have been written on money, banking and credit. And much of that work has been excellent. Personally, I follow a few leading bank and credit market services myself, and I find them extremely valuable.

But one of the studies which I have presented in the past provides a sort of do-it-yourself bank credit study for all who are interested and ambitious enough to follow it. And the extraordinary thing about this study is that it is available to everyone at no cost. It consists of following the trend of the D-J Utility and the D-J 40-Bond Averages, and perhaps charting these two Averages together.

Both of these two widely-followed Averages are sensitive to bank credit, money and interest rates. The 40-Bond Average is immediately sensitive to money conditions since the movements of this Average are affected, among other things, by prevailing monetary and political conditions and interest rates. The Utilities are heavily dependent on debt financing and therefore money rates. Utilities are also somewhat competitive with bonds, and many consider the Utilities to possess the income advantages of bonds together with the growth properties and inflation-hedge properties of common stocks.

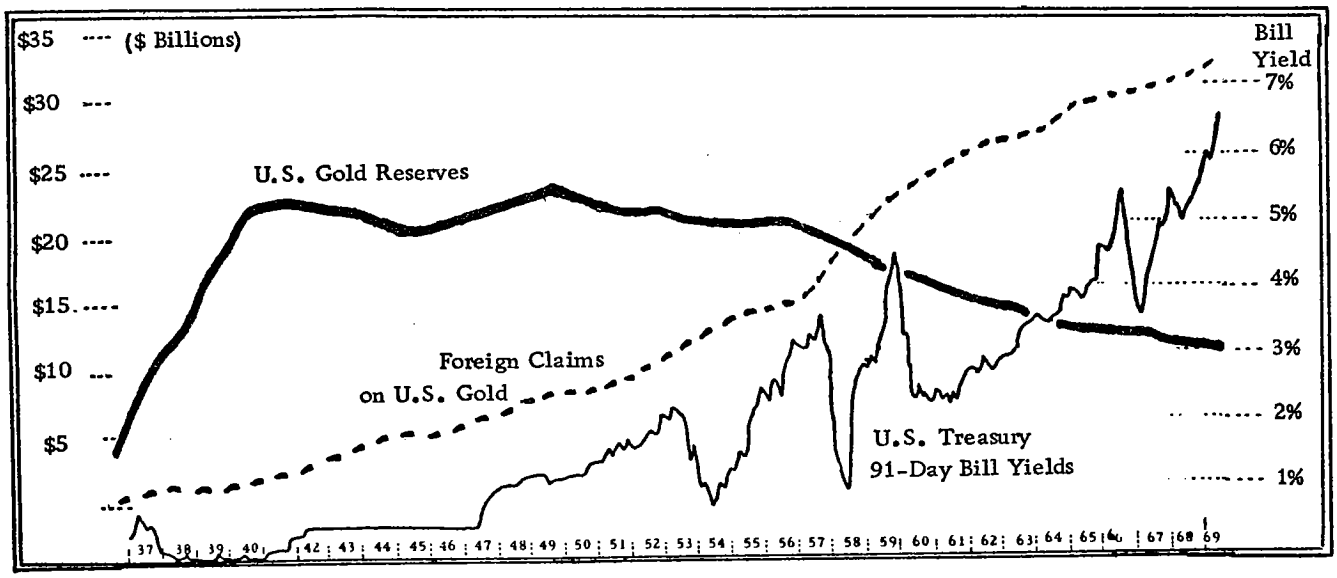
I have included a chart showing the path of the D-J Utility and 40-Bond Averages since 1946. The chart can probably be interpreted in a dozen sophisticated ways, but I watch to see when the two Averages embark on definite trends in the same direction. The shaded portions on the chart indicate areas in which the two Averages were both in established downtrends. In every case, where this occurred, the stock market ran into trouble. Or to put it another way, the Utility and Bond Averages tend to decline during periods of monetary adversity. During those periods, the mass of common stocks tend to be hurt by the same restrictive or strained monetary conditions.

The first period of joint decline in the two Averages occurred from the middle of 1946 to the end of 1947. The market during that period was an extremely rough affair. The next period of decline in the two Averages occurred during early 1953, and again a reaction hit the stock market. The shaded portion in 1957 produced a rather severe drop on Wall Street. The 1959 shaded portion was accompanied by declining market breadth, followed by a bad market slide in 1960.

The shaded portion which began in mid-1965 gave warning of the approaching end of the whole 1949-1966 bull market. During 1966, the bear market embarked on its first downward leg. The 1967 shaded area on the chart was accompanied by a drop in the Dow from 943 to 825.

The latest shaded area in the chart began in December, 1968. It has continued for 8 months right up to the present. On August 15 the D-J Utility and 40-Bond Averages broke to simultaneous new lows, Utilities to their lowest point since 1962 and Bonds to their lowest level since 1933.

Based on the chart, the market continues to be in the "danger area." A well established downtrend exists in both the Bond and the Utility Averages, providing evidence that the monetary atmosphere is negative for common stocks. We should know in time whether this chart is continuing to provide correct signals.



GOLD AND INTEREST RATES: Sometimes I get tired of all the nonsense written about gold. A good chart can often act like a knife, it can cut through the clouds of fog. I have drawn a chart showing three indicators, the U.S. 91-day Treasury Bill rate since 1937, the U.S. Gold Reserves since 1937 and the Foreign claims on U.S. Gold.

A glance at the chart will show the following: First, interest rates were steady and low during 1937 to 1946. Second, during that same period the U.S. was accumulating gold, even though foreign claims on our gold were rising.

Third, beginning around 1950, while foreign claims on our gold were still rising, the U.S. began to lose gold. At this point yields on Treasury bills started rising. Around 1957 the U.S. gold losses began accelerating. Those losses have continued

until the present, and all the while foreign claims have expanded. During the period from 1957 to the present, against a background of gold losses and rising foreign claims the yields on Treasury bill rates exploded.

The conclusion is clear. The lower our gold reserves and the higher the foreign claims against our gold, the higher the interest rates needed to "protect" the dollar. The U.S. balance-of-payments is now worsening and foreign claims on U.S. gold are still building. With the prime rate now above the 6% peak rate of 1929, the U.S. has its back against the proverbial wall. What next?

U.S. gold stocks are declining because foreign claims are building and a certain portion of those foreign dollar claims are being converted into gold. If the dollar was "as good as gold," foreigners would keep their claims in dollars and collect the interest. They are not. Trust in the dollar has been waning.

What could change this situation? A severe recession or depression could conceivably work to make the U.S. competitive again, it could drive down prices so that U.S. exports would get more in line with imports (imports would probably drop massively during a depression). Or, the price of gold could be revalued upwards with appropriate realigning of major currencies. This would serve to re-price U.S. goods in terms of world markets, and it would discourage gold hoarding, since gold would be amply valued and there would be no sense in individuals holding non-interest bearing gold in lieu of interest-bearing U.S. Treasury bills.

As things stand now, with inflation still rampant in this country, with foreign claims still rising, with our balance-of-payments situation a disaster, no fundamental solution is in sight. Meanwhile, the hundreds of billions of dollar-debts in this nation are subject to the highest interest rates in a century. The compounding of these interest charges will serve only to squeeze the nation dry.

Money rates will only come down through a higher price for gold or a depression (and accompanying drying up of demand). That is the fundamental situation, and those who have patience will see the results of those fundamentals express themselves, either in a severe recession (depression), a rise in the price of gold or both.

INTERNATIONAL PICTURE: Without notifying Washington or the I.M.F. (and nations embarking on devaluation are required to ask I.M.F. permission) France devalued the franc by 11.1% in terms of gold. The devaluation was obviously insufficient, and already the forces of inflation are pressing again in France. Following the devaluation, prices in France (despite an official freeze until Sept. 15) rose rapidly with Airline fares jumping the full amount of devaluation, beef and milk prices advancing and many French shops raising their prices. The powerful French labor unions announced that they would ask for large wage increases in the fall. How the French will react to new austerity measures which were brought in with the devaluation cannot yet be gauged.

In devaluing, the French were attempting to align the franc with the German mark. But immediate pressure should bear on other currencies to align with what must now be considered the strongest currency in the world, the mark. The Italian lira could devalue next, followed (or preceded by) the tottering Belgian franc. Following the lira and the Belgian franc, I would expect Netherlands to follow, and then the British pound (which could either be devalued again or set free to "float" as the London Economist has been advocating for over a year).

The authoritative London Economist noted in its latest issue: "Until last weekend the French franc and the pound sterling were the two least desirable currencies among those held in any quantity around the world. Now sterling stands alone." Of the British trade situation, the Economist commented: "Britain's monthly trade figures have become almost the worst joke in the world, since if it is not the weather it is a strike, or a computer error, or something out of the blue that accounts for their poor performance. (Ahead the Port Talbot steel strike will knock late summer figures)." Currently, markets of the world are getting a lift simply because the French devaluation did not immediately send shock waves around the world. It would appear that the pressure is to come later, perhaps weeks or months from now. But come it will.

The world is on the edge of a two-bloc system, the one to be based on U.S. fiat dollars, backed by promises rather than gold, and the other to be based on the German mark with other European currencies (devalued and adjusted to align themselves with the mark).

At this point it is well to note that Germany possesses around $7 billion in gold, figuring her $5 billion in Treasury gold plus Roosa gold-backed bonds. Against this, the U.S. has approximately $10 billion in gold against which she owes $30 to $35 billion in international debts.

 I believe we are slowly moving into an area of monetary war between the two potential blocs. Money is still sporadically pouring into Germany, much of it dollars. As one European currency after another lines itself up with the mark, the wisdom of owning over-valued dollars is going to come more and more into question. So far, Germany has not put pressure on the dollar by calling gold for dollars. Rather, she has redeposited her dollars in New York.

But in the face of the continuing horrendous U.S. balance-of-payments figures and in the face of the continuing galloping U.S. inflation, it is a question of how much longer Germany will "help" the U.S. It is now almost past the point where gold guarantees make sense (the U.S. does not own enough gold).

If, at any time, the U.S. announces to Germany that she cannot provide any more gold for dollars, we will have demonitization. At that point the Free World will be split into two money blocs and trade between the U.S. (and Britain) and the rest of the Free World will grind to a halt.

Much of this has been covered up or ignored in U.S. press coverage, but I foresee it happening over the next year or so. It is going to be one of the biggest monetary and trade messes of the century, and it will be reflected in every segment of U.S. economic life. It will also be reflected in the U.S. stock market where it is said that foreigners are already cutting way back on U.S. stock purchases. Remember, it was the great inflow of foreign funds into the U.S. market last year which helped our balance-of-payments on a liquidity basis. Withdrawal of foreign funds will have just the opposite effect. That effect is now in progress.

ECONOMIC SCRAPBOOK:

August 15.....Auto sales for the first 10 days of August were down 10% over last year.
The Dept. of Commerce announced the U.S. B.O.P. deficit deepened to $3.7 billion, twice as poor as in any other quarter.
Corporate profits (pretax) declined for the first time since early 1967.
The Fed kept minus reserves at the banks right at $1.3 billion against $1.1 billion the previous week.

August 18.....Industrial output rose .7% to a record while housing starts dropped 9% to a rate of 1.33 million per year.

August 19.....In the absence of further monetary dislocations over the weekend, the pound rallied sharply and silver prices slid 2¢ to 3¢.
Treasury 91-day bills rallied to bring their interest rates down to 6.95%.

August 21.....The N.Y.S.E., suffering from decreasing volume, seeks to go back to 5-hour sessions.
Giant Alcoa went along with Aluminum price increases posted by competitors.

August 22.....Durable goods orders rose 5.5% in July, thereby frustrating the Administration's anti-inflation efforts.
The Fed kept bank reserves tight at a minus $1.23 billion for the week.

August 25.....Car sales continue to lag with the second 10-days of Aug. down 8.9%.
July machine-tool orders dropped 22% as buyers awaited the disposition of the 7% investment tax-credit.
The D-J Municipal Bond Yield Index pushed to 6.02%, the first time over 6% in its 40-year history.

LATE NOTES: Even the bears are predicting a corrective rally to 860 or thereabouts. I want to warn subscribers again as this Letter ends that primary bear markets do not work like primary bull markets. Rallies in bear markets can be half-hearted or explosive, they can end with an upside explosion or simply fade while the floor opens up under the market. I agree that by most criteria of the past two decades Wall Street appeared sold-out and ready to move up at the July 29 lows. Yet this market still shows definite weakness; for instance on August 25 (Monday) as the Industrials slipped 5 points both Dow Steels (Bethlehem and U.S.) dropped to new lows for the year. My advice—be careful and do not subject your indicators to the same interpretations which you used when the primary trend was bullish.